ESO 1764

1991
Agricultural Outlook Overview

National Economy
Agricultural Policy
Farm Income and Finance

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November 1990

National Economy

The economy is nearing or in recession. Of concern is the length and depth of that recession, and what it will do to agriculture. Recession is defined as two consecutive quarters of declining Gross National Product (GNP).

Slide: National Economy: Contributors to Recession

- *Inflation, then tight money.*
- *Stagnating economy.*
- *Rising energy costs, Gulf crisis.*
- *Declining consumer confidence.*
- *Budget deficit.*

Each of these elements will influence GNP.

A typical recession follows tightening of the money supply after a bout of inflation. Inflation (excluding food and energy prices) increased from a base rate of about 4% in 1987 to 5% in the first three quarters of 1990. That wasn't much by early 1980's standards but was enough for the Federal Reserve to tighten the money supply. Money supply (M2) expanding 2% annually in 1990 isn't enough to keep the economy growing in 1991.

Slide: Economic Growth and Inflation

A tendency toward stagflation (a combination of a stagnant economy and inflation) is apparent in the figure from the declining GNP growth rate associated with higher inflation. The figure illustrates that the economic boom (which began 8 years ago) is losing its momentum. The growth rate of the economy has slowed from approximately 5% in 1987 to a less than 1% average in the first two quarters of 1990. GNP was up a surprising 1.8% in the third quarter, but that number is the only good news among a lot of bad news. The number is likely to be revised downward.

Rising energy costs absorb income which would have been used to purchase other commodities, and will further reduce economic growth.

Slide: Consumer Confidence Index: The Conference Board

Declining consumer confidence reduces expenditures for goods and services, slowing the economy. When tight money supply and a stagnating economy are combined with rising energy costs and consumer concerns about the future prospects in the Middle East, it is not surprising that consumer confidence has fallen. The decline was rather steady in 1989 and the first seven months of 1990.

Slide: Federal Budget Deficit

Higher taxes and lower federal expenditures called for by the October budget accord will reduce aggregate demand and slow the economy. Despite Gramm-Rudman-Hollings legislation calling for a balanced budget by 1993, budget deficits for 1990 and 1991 are projected to be near all time highs even after the budget deficit reduction package. The October package is designed to reduce the budget deficit by nearly $500 billion over five years and by $40 billion in 1991. The package was designed to restore confidence in the ability of Congress and the executive to govern but the difficulties of reaching an agreement have thwarted that goal. On the other hand, reducing aggregate demand by reducing buying power in the economy on the eve of recession is not the way to get the economy moving again.

Slide: Federal Debt as Percent of GNP

The federal debt was 57% of the GNP in 1990, far below the 127% recorded in 1946. However, the relative debt burden may be greater today. Massive domestic and foreign debt, inadequate savings and investment, stagnant productivity growth, intense economic competition from Japan and European Community as well as other factors all point to the federal debt as being of great concern today. Many American firms are over-leveraged. An economic downturn will cause many business failures which in turn will cause bank failures and further losses to deposit insurance.

Some signs point to a shallow recession followed by a slow and uneven economic recovery. These signs include the fact that inventories are not large, the stock market has not been substantially over-priced, inflation has been modest and hence does not need a big economic tightening to correct it, and (with luck) the oil price shock may be short-lived.

Slide: Economic Outlook: Real GNP

In summary, key predictions for 1991 are as follows:

GNP - overall growth rate 1% for 1991 but low to negative growth in first half.

Unemployment - 6 to 7%.

Inflation - 7% in early 1991, but falling to 5% by the end of the year.

Slide: Impact of Economy on Agriculture

- *Interest rates.*
- *Exchange rates.*
- *Trade balance.*
- *Off-farm income.*

The recession influences agriculture primarily through interest rates, exchange rates, trade balance, and off-farm income. Nowadays, national recession has relatively little impact on agriculture through national income and unemployment. This contrasts with former times when demand for farm output was highly sensitive to income. An exception is beef which remains sensitive to income.

Slide: Interest Rates: U.S. Government Securities

Interest rates fell somewhat since early 1989 but increased modestly again as 1990 wore on and the money supply was tight. Interest rates will moderate only a little despite the budget accord and the slowing economy. The Federal Reserve will need to continue tight money to avoid inflation brought on by petroleum price hikes and to retain foreign capital to finance the national debt.

Slide: Exchange Rates: Trade-Weighted Value of the Dollar

The dollar has fallen substantially since early 1985. It revived again slightly in 1989 and then has fallen again. The change in the value of the dollar for any commodity depends on where it is sold. The value of the dollar for agricultural commodities has declined less than for other commodities because agricultural commodities are sold to countries which have not devalued very much with respect to the dollar. The major dollar devaluations have occurred in relation to Japanese and European currencies. Hence soybeans which are sold mostly to such developed countries have declined in value most in foreign exchange. Wheat has declined least because much of it is sold to developing countries which have not devalued relative to the dollar.

The "squares" in the slide for July 1990 indicate the exchange rate for farm commodities as of that date. Note that all of these squares lie above the aggregate exchange rate for all commodities.

Slide: Trade Balance: 1980-1989

Despite less decline in the exchange rate for agricultural than for other commodities since 1973, agriculture has performed better in international trade than other commodities. Other commodities especially show recent signs of a turnaround. The trade balance for nonagricultural commodities is becoming less negative and the trade balance for agricultural commodities is becoming more positive. The value of the dollar is likely to continue to remain low and keep U.S. commodities highly competitive in international markets.

An offsetting problem is that a recession in the U.S. is "exported" by reducing our imports from other economies. This will slow other economies which in turn will reduce their demand for U.S. farm and other exports. I project that U.S. farm exports will be down from the $40 billion in 1990 to $38 billion in 1991. Good harvests abroad in 1990 also contributed to this trend.

The final factor to consider is off-farm income. Half of the income of U.S. farmers comes from off-farm sources. In Ohio, 75% of income comes from off-farm sources. Economic analysis indicates that higher unemployment in the national economy reduces opportunities for farmers to earn off-farm income. This is partly offset by more aggressive search for off-farm employment by farmers during recession.

The Ohio economy has been performing a little better than the national economy in recent months. Recently, the state has had lower rates of unemployment than the nation. The structural adjustments that the Ohio economy has made since 1980 and the low value of the dollar will help the state's international competitiveness. Ohio may perform a little better than the average state in 1991 because of the strong international demand for its products.

Farm Policy

Key issues in new farm legislation are cropping flexibility, budget cuts, and the environment.

Slide: Farm Policy: Cropping Flexibility

The key feature of new farm legislation is cropping flexibility and budget cuts through the triple base plan. This feature has reduced the acres eligible for deficiency payments by 15% -- with further cuts in store for later years.

The *first base* is a farmer's traditional allowable acreage of program crops. The *second* or *program base* is that first base less land which must be diverted to soil conserving uses, which will be 15% of the base for wheat and 7.5% of the base for feed grains in 1991.

The third or payment base is the amount of the base on which farmer's receive payment, which is reduced by 15%.

In addition to the triple-base plan, there is a flex base of up to 10% of the overall crop base. It gives the farmer the option to produce program or other crops on flex acres without losing program history or loan coverage but with loss of deficiency payments. That option won't get much use. Loan rates are available on program crops produced on flex acres or triple base flex acres.

Target prices are maintained at 1990 levels. The 15% reduction in payment acres essentially means a 15% reduction in deficiency payments. In addition, after 1993 the deficiency payments will be based on prices in the twelve-month marketing year rather than the first 5 months as previously.

The soybean marketing loan is another major new innovation. It provides a market loan of $5.02 per bushel but with a 2% loan assessment which reduces the effective marketing loan to $4.92 per bushel. Projections suggest that soybean prices will average above the marketing loan, but opportunities for planting soybeans on flex acres could result in a large crop, bringing the price below the marketing loan. The program will improve our international market share but will raise objections from competing exporters in South America.

The changes in programs will provide considerable flexibility in programs which will allow greater response to market incentives and opportunities to pursue soil conserving rotations.

Slide: Farm Policy: Budget Cuts

Projections are for $13.6 billion of federal savings compared with continuation of the 1990 farm bill. Farm income is expected to be down a like amount over five years. While the reduction to $42 billion of program outlays represents a 25% cut from continuation of 1990 programs, it represents nearly a 50% real cut in overall supports when inflation is factored in. Use of the twelve-month market price average to compute deficiency payments after 1993 is designed to further reduce deficiency payments and program costs.

A problem with these changes is that program participation rates could drop, jeopardizing supply control features of the program. In addition, reducing U.S. supports ahead of GATT trade negotiations reduces our bargaining power. We will have already made the adjustments that we are trying to get the Europeans to agree to. However, the new farm bill contains significant outlays for export subsidies which will keep some pressure on the European Community.

Slide: Farm Policy: Environment

The new farm bill has been widely touted as environmental legislation. It makes very modest additions to 1985 legislation, however. It provides for one million acres of wetland conversion through long-term crop easements, for moving the conservation reserve program to 40-45 million acres (the same as under 1985 farm legislation), and for nationwide organic food standards and labeling. Pesticide record keeping requirements pose no immediate threat to farmers but could be used to control chemical use in future years.

Thus far environmental provisions have emphasized the carrot of financial incentives to participate rather than the stick of mandatory participation. Apparently, the main victory for environmentalists in the 1990 farm bill was retention of sodbuster, swampbuster, and conservation compliance features of the 1985 farm bill.

Farm Income and Finance

Slide: 1991 Farm Income and Finance

Gross cash farm income is projected to be down $3 billion from 1990 primarily because of lower exports and reduced deficiency payments. Expenses are projected to be up $2 billion in 1991 primarily because of rising energy costs. Net cash farm income is projected to be down $5 billion in 1991 from 1990. Because inventories are expected to accumulate less in 1991 than in 1990, net farm income is projected to be down $7 billion from 1990.

Slide: Real U.S. Gross Cash Farm Income

High real *net* farm income realized in recent years did not come from rising U.S. real *gross* cash farm income. In real terms, crop receipts declined in the first half of the 1980s and have remained rather steady since the mid-1980s. Livestock receipts have performed better. Government payments and other income increased to the mid-1980s and then have decreased. Overall gross cash farm income fell to the mid-1980s and since then has held rather steady.

Slide: Real U.S. Farm Production Expenses

Farmers have made impressive reductions in farm production expenses. That is particularly apparent in the case of interest outlays and manufactured inputs (outlays for fertilizer, fuel, and pesticides). Falling land prices and declining interest rates account for the reduced interest expenses. Higher petroleum prices will increase manufactured input expenses in 1991. Thus the significant downturn in production expenses apparent since 1980 is expected to reverse in 1991.

Slide: Real Farm Income and Expenses: 1980-1990

Production expenses have fallen more than gross farm income, leaving steady to increasing real net farm income in the last half of the 1980s.

The new farm bill makes farm income more dependent on markets and less on the government. Farm markets are expected to remain stronger in 1991 and beyond than in the mid-1980s. However, the farm economy is expected to be less prosperous in the early 1990s than in the late 1980s and 1990. I do not anticipate a return to financial stress similar to that experienced in the mid-1980s, however.

Slide: Farm Balance Sheet

Real farm assets fell sharply in the first half of the 1980s and then leveled off in value. Debt has declined steadily but by more modest amounts overall. The result is a fairly favorable net worth position for farmers as they stand on the threshold of 1991.

The debt-asset ratio of 15% in 1990 is expected to continue unchanged in 1991.

Slide: Farm Balance Sheet Ratios

Farm asset values (especially land prices) are expected to decline slightly in 1991 primarily because of reduced net farm income and uncertainties about the future. The decline would be larger except for the favorable momentum toward higher land prices carried over from recent years. Debt is expected to remain nearly stable and net worth is expected to decline modestly.

Debt-to-asset and debt-to-net-cash-income ratios are far more favorable in 1990 than in earlier years of the 1980s. Thus the farming economy will be "lean and trim" entering a period of relative austerity in government commodity programs. This permits farmers to survive financially on less gross income than in earlier years. Financial vulnerability, defined as farms with debt to asset ratios of over 40% and negative cash flow, has declined from 12% in 1984 to 5% today.

Given anticipated future cuts in farm program payment base and lower deficiency payments, it is apparent that the future of agriculture will depend very heavily on markets, particularly export markets. Agriculture will remain strong in 1991 but will not do as well as in 1990.

Rarely has a farm economy faced so much uncertainty. Specific forecasts have more than the usual range of error around them because of these many uncertainties. If war breaks out in the Gulf or if recession is worldwide and deep, all bets and forecasts are off.